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Nos. 06-1457, 06-1462

In The
Supreme Court of the United States

MORGAN STANLEY CAPITAL GROUP INC.,
Petitioner,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY WASHINGTON, ET AL.,
Respondents.

CALPINE ENERGY SERVICES, L.P., ET AL.,
Petitioners,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY WASHINGTON, ET AL.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, THE NEW ENGLAND CONFERENCE OF PUBLIC UTILITIES COMMISSIONERS, AND THE NEW JERSEY BOARD OF PUBLIC UTILITIES AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission, on remand, must reexamine "market-based" contract rates in complaint proceedings filed under Section 206 of the Federal Power Act, 16 U.S.C § 824e and determine if they are "unjust, unreasonable, unduly discriminatory, or preferential," as the statute requires, where the contracts were consummated in a severely dysfunctional market lacking an effective federal oversight mechanism?

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INTEREST OF *AMICUS CURIAE*[1]

The 2000-2001 Western energy debacle, accurately described by the Federal Energy Regulatory Commission ("FERC") as "*the worst electricity market crisis in US history,*"[2] was characterized by market abuses, rolling brownouts and skyrocketing energy prices.[3] As a result of these factors, it drew the attention and concern of policy makers, including State public utility commissions, nationwide. State commissions have a special and indisputable interest in assuring meaningful review of the rates contained in the contracts consummated during that crisis and challenged in these proceedings. Indeed, the Federal Power Act ("FPA") reflects a "special solicitude" for State authorities "designed to recognize precisely th[is] interest of the States in protecting their citizens in this traditional governmental field of utility regulation."[4]

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1 Petitioners and respondents have consented to the filing of this brief in letters on file in the Clerk's office. Pursuant to Sup. Ct. R. 37.6, *amici* state that no counsel for a party authored this brief in whole or in part and that no counsel or a party made a monetary contribution intended to fund the preparation or submission of the brief.

2 FERC August 5, 2007 Brief in Opposition at 12. {Emphasis Added}("FERC Op. Br.").

3 *California ex. Rel. Lockyer v. FERC (Lockyer)*, 383 F.3d 1006, 1014 (9th Cir. 2004), cert. denied, 127 S. Ct. 2972 ("[N]on-compliance with FERC's reporting requirements was rampant . . . while energy prices skyrocketed and rolling brownouts threatened California's . . . citizens.")

4 *Maryland People's Counsel v. FERC*, 760 F.2d 318, 320-21 (D.C. Cir. 1985) (Scalia, J.) {Emphasis Added} This decision construes a provision of the Natural Gas Act that is

The National Association of Regulatory Utility Commissioners ("NARUC"), founded in 1889, is composed of those State commissions from all fifty States, the District of Columbia, Puerto Rico, and the Virgin Islands responsible for regulating, among other things, retail electric and natural gas service. Both Congress[5] and federal courts[6] have consistently recognized NARUC as a proper entity to represent the collective interests of State commissions. Two others join NARUC in submitting this brief: the New England Conference of Public Utilities Commissioners, Inc. ("NECPUC"), a regional affiliate of NARUC representing regulators in six New England states,[7]

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the analogue to FPA § 308, which authorizes FERC to admit States as parties to any proceeding, see 16 U.S.C. § 825g(a). The D.C. Circuit concluded that States have standing before FERC *to protect the interests of the public*, apart from the interests of the signatories to a challenged contract. *Maryland People's Counsel*, 760 F.2d at 320-21.

[5] See 47 U.S.C. § 410(c) (1971) (Congress designated NARUC to nominate members of Federal-State Joint Boards to consider issues of concern to both the Federal Communications Commission and State regulators with respect to universal service, separations, and other matters); Cf., 47 U.S.C. § 254 (1996) (describing functions of the Joint Federal-State Board on Universal Service). Cf. *NARUC, et al. v. ICC*, 41 F.3d 721 (D.C. Cir 1994) (where the Court explains: "Carriers, to get the cards, applied to... [NARUC], an interstate umbrella organization that, as envisioned by Congress, played a role in drafting the regulations that the ICC issued to create the "bingo card" system).

[6] See *United States v. Southern Motor Carrier Rate Conference, Inc.*, 467 F. Supp. 471 (N.D. Ga. 1979), aff'd 672 F.2d 469 (5th Cir. 1982), aff'd en banc on reh'g, 702 F.2d 532 (5th Cir. 1983), rev'd on other grounds, 471 U.S. 48 (1985).

[7] NECPUC is a non-profit corporation representing every utility regulator in Connecticut, Maine, Massachusetts,

and one individual member of NARUC, the New Jersey Board of Public Utilities ("BPU").

NARUC and its member commissions have a vital interest in this appeal. The standards that apply in the *only* forum realistically available to protect consumers from unjust and unreasonable prices *in wholesale markets* are at issue in this proceeding. State commissions' special interest in this appeal is stems from their legal responsibility to ensure that needed energy services are provided at just and reasonable retail rates. According to FERC's own staff, conditions in the western markets ultimately led to increases in wholesale contract rates of as much as 33 percent.[8] When setting retail rates for consumers, State regulators in traditionally-regulated jurisdictions may be required by Federal law to allow utilities to pass through any costs of wholesale power FERC authorizes to retail customers.[9] Specifically, they

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New Hampshire, Rhode Island and Vermont. It provides regional regulatory assistance on matters of common concern to the member States.

[8] FERC Staff found that anticompetitive conditions in the spot market affected forward market prices, distorting them by up to 33%. See *Staff Report: Final Report on Price Manipulation in Western Markets* (March 2003)("*Staff Report*"). Supp. J.A. 199sa-200sa, 206sa; See *San Diego Gas & Elec. Co.*, 93 FERC ¶ 61,121, ¶ 61,367 (2000)("These higher spot market prices in turn affect the prices in forward markets."). FERC now concedes that " . . . the dysfunction in the spot market had an effect on the prices available in the forward market." FERC Nov. 21, 2007 Brief on the Merits at 44 ("FERC Merits Br.").

[9] Under *Nantahala Power & Light Company v. Thornburg*, 476 U.S. 953, 966 (1986), "[o]nce FERC sets [an interstate wholesale rate for electricity], a State may not

cannot, in many instances, decline to accept a FERC determination of the reasonableness of wholesale power costs in setting retail rates. Even in States that have elected to restructure provision of retail electric service, the prices charged in FERC-jurisdictional wholesale markets have a direct influence on the cost of generation service provided to end-user customers.

The FERC decision remanded by the Ninth Circuit examines the application of the *Mobile-Sierra* doctrine[10] to several specific market-based contracts consummated in a unique regulatory environment characterized by severe market dysfunction. This Court's decision will determine the procedures that FERC must follow and the standards FERC (and courts reviewing the agency's actions) must apply in such circumstances, i.e., when wholesale power contracts entered in a dysfunctional market affected by market power, market manipulation, or other factors, are challenged as violative of the FPA's mandate that FERC-jurisdictional rates be just and reasonable.

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conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable."

[10] The so-called *Mobile-Sierra* doctrine is derived from two contemporaneous Supreme Court cases. The decisions in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956), establish the principle that, in certain circumstances, rates derived from wholesale energy contracts are presumed "just and reasonable" under the FPA. FERC may undo such rates only in the event that the contract in question is contrary to the public interest, a finding that FERC is willing to make only in, what the agency determines are, extraordinary circumstances.

Whatever the relative merits of the rationale adopted by the Ninth Circuit, one thing is clear: the FPA requires FERC to re-examine the subject contracts to determine if they indeed contain "just and reasonable" rates. In the circumstances presented here -- a severely dysfunctional market that materially affected the contracts at issue -- the presumptions of the *Mobile-Sierra* doctrine should not apply. The Ninth Circuit has articulated an approach that is generally consistent with Congress' expectations. The decision confirms earlier precedent from various circuits that market-based regimes are permissible under the FPA, but specifies that application of the Mobile-Sierra doctrine is permissible "only . . . when accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change." *Public Utility District No. 1 of Snohomish County, et al. v. FERC* ("*Snohomish*"), 471 F.3d 1053, 1080 (9th Cir. 2007). This Court should affirm the basic thrust of the Ninth Circuit's decision concerning the applicability of the *Mobile-Sierra* doctrine and allow the FERC to reexamines the unique circumstances of this case using the proper standard on remand.

STATEMENT OF THE CASE

NARUC adopts by Reference the "Statement" of the facts found in the "Brief of the Respondents Public Utilities Commission of the State of California and California Electricity Oversight Board" at pages 1 – 16.

SUMMARY OF ARGUMENT

Petitioners contend this case is about proper deference to agency expertise and threats to the stability of electric markets and infrastructure development. It is not. This case is about FERC's fidelity to congressional mandates that it act to assure just and reasonable rates. It is about a federal market oversight regime that, during the 2000-2001 western energy crisis, indisputably failed to protect consumers as Congress required. It is about the agency's application of a judge-made rule, the *Mobile-Sierra* doctrine, in a manner that those judges could not possibly have intended.

Petitioners argue that FERC's findings deserve deference under the two-step analysis this Court established in *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984). The clarity of the statutory text necessarily truncates the *Chevron* inquiry at step one. The Federal Power Act *mandates* both that all rates "shall be just and reasonable," and that FERC *must correct* rates that are not. 16 U.S.C. §§ 824d(a), 824e(a). Despite this unambiguous mandate and the presence of evidence strongly suggesting the market in which the subject contracts were consummated was severely dysfunctional, FERC refused to evaluate the lawfulness of the contract rates using the FPA-mandated standard. Before the Ninth Circuit, FERC simply argued that the FPA's traditional just-and-reasonable standard did not apply. As the Ninth Circuit recognized, this approach to the subject Section 206 complaint proceedings "cannot

be squared with the statutory scheme." *Snohomish*, 471 F.3d at 1084.

Petitioners also argue that the *Mobile-Sierra* doctrine was properly applied to the subject contracts. But the doctrine was never meant to apply in the circumstances presented. The FPA sets forth a single statutory standard that binds FERC: all wholesale electricity rates must be "just and reasonable." In both the *Mobile* and *Sierra* decisions – the *actual contract rates* were subject to a FERC review to assure they were just and reasonable. Here that review of the specific rate did not occur. In any case, where (i) the market is severely dysfunctional, (ii) inadequate FERC market oversight mechanisms fail to ensure the presence of a workably competitive market, and (iii) the record suggests contract rates were materially impacted by the resulting market dysfunction, the critical preconditions that justify application of the *Mobile-Sierra* doctrine are not present, so it should not apply. In such cases, FERC should address requests to reform contracts entered at market-based rates by determining if they are just and reasonable. Any other approach inevitably exposes wholesale power purchases (and the end-users they serve) to the full impact of seller market power and manipulative conduct with no recourse.

Finally, Petitioners allege that if this Court requires FERC to re-examine these contracts, it will threaten the stability of energy markets or impair the development of needed infrastructure. Such rhetoric lacks merit. The unusual market conditions the Ninth Circuit relied upon to justify review of the subject contracts are unlikely to recur

– in part because of adjustments Congress and FERC have made to the federal market oversight regime.

But, even if the decision below does result in a significant increase in the level of scrutiny FERC applies to wholesale electric contracts, history suggests that markets can efficiently accommodate such reviews. For years, wholesale electric markets operated through tariffs and contracts subject to challenge and federal agency review. Many States retain some authority to review contracts entered by jurisdictional utilities for reasonableness and prudence. In both cases the reviews have been readily accommodated by the capital markets and market participants.

Moreover, re-examination of the subject contracts in these circumstances can only make the markets operate more, not less, efficiently. Increased scrutiny of wholesale electric contracts entered during severely dysfunctional markets will only make clear what market participants should know already: If the United States experiences *another episode of extreme market dysfunction*, sellers seeking either to manipulate the market or to take advantage of the manipulation of others, should anticipate that their contracts may be reviewed. Given the likely limited application of the Ninth Circuit's decision – distinguishable from most future cases by the presence of an enhanced FERC market oversight regime and the absence of the most dysfunctional electricity market "in US history" – it is difficult to give credence to contention that upholding the Ninth Circuit will have a significant impact on future market stability or infrastructure development. However, even if it

does, Congress made no "market stability" exception to its mandate that contract rates be just and reasonable and that FERC correct those that are not. On remand, FERC should reexamine the evidence of the soundness of the forward energy markets during the Western energy crisis. If the agency concludes those markets were not effectively competitive, it should determine whether the rates in the challenged contracts were just and reasonable using traditional standards and order any needed reformation. This is the only way to ensure compliance with the FPA's mandates and protect consumers.

ARGUMENT

Arguments to reverse the decision below fall into three general categories. Petitioners and their supporters contend that (i) FERC's determinations are owed *Chevron* deference,[11] (ii) FERC correctly applied an effectively irrebuttable presumption of validity to the contracts at issue,[12] and (iii) if, the Ninth Circuit's decision is not overturned, the stability of energy markets, the willingness to of market participants to enter long term contracts and related "infrastructure development" in "new generation and transmission" will be threatened.[13]

All three contentions lack merit.

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11 FERC Merits Br. at 19-21.

12 *Id.* at 38-47.

13 *Id.* at 23-25, 37; Morgan Stanley November 21, 2007 Brief on the Merits at 36-38 ("Morgan Stanley Merits Br."); Calpine November 21, 2007 Brief on the Merits at 47-56 ("Calpine Merits Br.").

I. FERC'S ORDERS ARE NOT ENTITLED TO CHEVRON DEFERENCE.

FERC, and its allies, argue that the agency's orders should be upheld as a reasonable application of the FPA's just-and-reasonable standard, which it "interpreted . . . to provide for a narrow review" that is "limited to determining whether the rates are contrary to the public interest."[14] According to the agency, the "court of appeals failed to appreciate that FERC's construction of Sections 824d and 824e is entitled to deference under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984)."[15]

To be entitled to deference under this court's *Chevron* decision, the controlling statutory text must be ambiguous. "If the intent of Congress is clear, that is the end of the matter . . . ." However, if the statutory text is ambiguous, reviewing courts are required to determine whether the agency's interpretation "represents a reasonable accommodation of conflicting policies" or if "it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."[16]

FERC's deference argument does not survive the first step of the *Chevron* analysis. The relevant statutory mandate is clear and FERC's approach negates it for the contracts at issue.

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14 FERC Merits Br. at 19.

15 *Id.* at 19-26.

16 *Chevron*, 467 U.S. at 845 (quoting *United States v. Shimer*, 367 U.S. 374, 382 (1961) (citations omitted)).

The Federal Power Act was enacted to protect consumers from excessive rates. It "requires the FERC to regulate public utilities for the benefit of consumers,"[17] specifies that unjust and unreasonable rates are "unlawful,"[18] and *mandates* both that "all rates . . . *shall* be just and reasonable,"[19] and that FERC *must correct* rates that are not just and reasonable.[20]

Despite this unambiguous statutory mandate and the presence of substantial evidence strongly suggesting that the market in which the subject contracts were consummated was severely dysfunctional, FERC refused to evaluate the lawfulness of the subject contract rates using the traditional just-and-reasonable standard or even an "interpretation" of the statute's just-and-reasonable standard. Before the Court of Appeals and in its original order, FERC simply argued that the FPA's

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17 *Snohomish*, 471 F.3d at 1058 (citing *Pa. Water & Power Co. v. Fed. Power Comm'n*, 343 U.S. 414, 418 (1952) ("A major purpose of the whole [Federal Power] Act is to protect power consumers against excessive prices."); *Lockyer*, 383 F.3d at 1017 (describing "protecting consumers" as the FPA's "primary purpose"); *Atl. Ref. Co. v. Pub. Serv. Comm'n*, 360 U.S. 378, 388 (1959) ("The [Natural Gas] Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges.").

18 16 U.S.C. § 824d(a)

19 *Id.* (emphasis added)

20 FPA § 206 provides that: "Whenever" FERC "shall find that any rate [or] charge," or any "contract affect[ing] such rate [or] charge" is "unjust, unreasonable, unduly discriminatory or preferential, the Commission *shall* determine the just and reasonable rate, charge ... or contract to be thereafter observed" and "*shall* fix the same by order." 16 U.S.C. § 824e(a) (emphasis added).

just-and-reasonable standard did not apply in these circumstances.[21] In its merits brief before this Court, FERC contends, for the first time, that the agency merely applied the just-and-reasonable standard through the public interest test. This post hoc rationalization is an obvious effort to rehabilitate its flawed legal reasoning below.[22] It

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[21] Brief of Respondent FERC, 9th Cir. Nos. 03-74208 *et al.*, at 82 (Sept. 22, 2004) ("the issue here is not whether the contract rates were unjust and unreasonable"). In a 2-1 decision, FERC insisted that "a finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there is a 'just and reasonable' standard of review." *Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Mktg. Co., Inc.*, 103 FERC ¶ 61,353 (2003). J.A.1275a-J.A.1276a. Instead, in its original order, FERC applied a separate "public interest" standard, stating that "to justify contract modification it is not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms, and conditions are contrary to the public interest." J.A.1275a-J.A.1276a. Commissioner Massey dissented. He contended that the challenged contract prices were "multiples of traditional prices, shockingly high prices, completely unprecedented by historic standards;" concluded that the prices were "unlawful by any reasonable measure;" and reasoned that FERC's "primary calling under the [FPA] is to ensure that prices are just and reasonable 24 hours a day, seven days a week." J.A.1301a-J.A.1302a. Commissioner Massey found "no persuasive public interest rationale for protecting and sanctifying contracts" that were tainted by such a "wildly dysfunctional" market and concluded that the high prices in these contracts were influenced by "the exercise of market power and widespread market manipulation." J.A.1317a-J.A.1318a.

[22] See footnote 21, supra..

effectively concedes that reversal of the FERC's initial determinations on this point is justified.

The clarity of the statutory text necessarily truncates the *Chevron* inquiry at step one. But even if that were not the case, FERC's dueling legal rationales would clearly fail the second step. Both FERC's initial approach in its decisions and before the Ninth Circuit, as well as its belated effort before this Court to rehabilitate its earlier reasoning[23] reach the same conclusion – no further review or relief is required. "[I]t appears from the statute [and] its legislative history" that the result FERC reached "is not one that Congress would have sanctioned." *Chevron*, 467 U.S. at 845. FERC's competing rationales both suggest Congress intended no review or relief from *what the record clearly suggests are unjust and unreasonable rates* simply because they are embedded in a contract. This result is the antithesis of congressional intent. The FPA specifically requires that contract rates be subject to review to ensure they are just and reasonable and requires the FERC to correct contract rates that fail to meet this standard.[24] As the Ninth Circuit recognized, FERC's "approach to section 206 cannot be squared with the statutory scheme."[25] Nor, in these circumstances, can it

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[23] Of course such rationalizations must, in any event, be ignored. Courts "cannot 'accept counsel's post hoc rationalizations for agency action'; for an agency's order must be upheld, if at all, 'on the same basis articulated in the order by the agency itself.' " *FPC v. Texaco Inc.*, 417 U.S. 380, 397 (1972)(quoting *Burlington Truck Lines v. United States*, 371 U.S. 156, 168-69 (1962).

[24] See 16 U.S.C. § 824d(a).

[25] *Snohomish*, 471 F.3d at 1084.

reflect "a permissible construction of the statute."[26] There simply is no basis to allow FERC to claim the benefits of *Chevron* deference.

II. THE *MOBILE-SIERRA* DOCTRINE SHOULD NOT APPLY WHERE THE RECORD SHOWS THE PRESENCE OF A SEVERELY DYSFUNCTIONAL MARKET THAT MATERIALLY AFFECTED THE CONTRACTS AT ISSUE.

The FPA sets forth only one statutory standard for determining the lawfulness of wholesale electricity rates. That standard requires that *all* rates be "just and reasonable." The Ninth Circuit concluded that:

> Market-based rate authority provides a meaningful opportunity for prior review and approval of rates under the FPA, an essential prerequisite to the *Mobile-Sierra* mode of rate review, *only* insofar as FERC implements and uses an effective oversight mechanism *after* the market-based rate authorization is initially granted. Only then can FERC meet its statutory duty to ensure that *all* rates are "just and reasonable."[27]

FERC, supported by Petitioners, disagrees and argues that efforts to improve the oversight

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[26] *Chevron*, 467 U.S. at 843.

[27] *Snohomish*, 471 F. 3d at 1081.

mechanism should be made directly and "not as a precondition for the application of *Mobile–Sierra*" and that any government oversight of markets will inevitably have imperfections that can be remedied in other ways.[28] This argument has no application to the contracts at issue in this case. The assumption implicit in this argument - that the regulatory regime in place today meets the Ninth Circuit's requirement for FERC implementation and use of an "effective oversight mechanism" - has no relevance to the time when these contracts were executed, since *no effective FERC oversight was in place at that time.*

The Ninth Circuit recognized the existence and importance of this distinction. The contracts at issue in the 1950's era *Mobile* and *Sierra* opinions were fixed-rate agreements filed with and subject to pre-approval by FERC using procedures in effect prior to the institution of the current market-based regime. At that time, FERC still employed a mechanism that allowed it to review contract rates in advance to assure they were just and reasonable. According to the *Mobile* and *Sierra* opinions, subsequent requests by sellers seeking to modify contracts entered in those circumstances to increase the agreed-upon rate could only be approved based upon a showing that the contract rates were no longer in the public interest. This public interest standard did not, however, become applicable until after FERC had had a genuine opportunity to review the underlying contract rate and determine that it was just and reasonable.

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[28] FERC Merits Br. at 32-34.

The contracts at issue in this case were executed under a very different regulatory regime in which FERC gave the sellers blanket authority to sell power at "market-based" rates. The courts have held that FERC has the authority to authorize wholesale power sales at market-based rates if the market in which those sales are made is workably competitive.[29] However, before FERC can lawfully grant blanket pre-approval to enter contracts to sell power at market-based rates, the agency must do two things. First, FERC must determine the seller lacks market power.[30] Second, FERC must be actively monitoring the relevant market[31] to ensure it remains workably competitive, i.e., to ensure that the seller has not begun to exercise market power or engaged in manipulative conduct and that the market as a whole has not become non-competitive. As long as the market remains workably competitive, there is reasonable assurance that any contracts consummated in such an environment will be just and reasonable, so application of the *Mobile-Sierra* standard to requests for reformation of such contracts may be appropriate.[32]

The situation presented in this case is starkly different. In this instance, FERC had

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[29] "In competitive markets, FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a just and reasonable results." *Consumers Energy Co. v. FERC*, 367 F.3d 915, 922-23 (D.C. Cir. 2004)(Roberts, J.)(internal quotation marks and citation omitted); see *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993); *Tejas Power Corp. v. FERC*, 908 F.2d 988, 1004 (D.C. Cir. 1990); FERC Merits Br. at 27-28.

[30] *Snohomish*, 471 F.3d at 1081.

[31] *Id.*

[32] *Id.*

before it indications that the market in which the contracts at issue here were consummated had become dysfunctional.[33] Although FERC earlier found sellers qualified for blanket authority to make wholesale sales at market-based rates, the market conditions existing at the time the contracts in question were actually executed clearly did not ensure that the contract rates were just and reasonable, in part because adequate FERC market oversight mechanisms were not in place. Under those circumstances, as the Ninth Circuit appropriately concluded, the fundamental precondition for the application of the *Mobile-Sierra* presumption (that a contract rate arranged with an entity lacking market power in a workably competitive market is just and reasonable) is simply not present. The only logical conclusion is that the presumption should not apply in the circumstances presented.

The Petitioners and FERC also argue that adequate protection for customers exists given the fact that FERC requires sellers to pass market power screens prior to authorizing the sale of power at market-based rates and disciplines sellers who engage in manipulative activities. That approach is not, however, sufficient to protect consumers in a severely dysfunctional market. In such a market,

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[33] The FERC *Staff Report*, footnote 9, supra, concluded that the spot market was dysfunctional, partially due to market manipulation by sellers, finding that "forward power prices negotiated during 2000-2001 in the western United States were significantly influenced by then-current spot power prices," and "that the trauma of the dysfunctional spot power prices at that time so influenced buyers that they placed great weight on these prices in forming future expectations." J.A. 25sa. FERC Op. Brief at 16-17.

even a seller that has properly obtained FERC blanket authority to sell at market-based rates and does not itself engage in manipulative conduct, can still obtain contracts for the sale of power at unreasonable rates as a result of the manipulative conduct of others. Any FERC action to discipline sellers exercising market power or manipulating the market will never provide relief for buyers (or the retail customers they serve) who purchase from those FERC-authorized sellers that simply benefit from the actions of others.

Under the approach advocated by the Petitioners and their supporters, purchasers (and end-users they serve) buying in such an environment stand exposed to the full impact of the dysfunctional market -- they are required to purchase an essential item in a market that is not workably competitive -- with no hope of ever obtaining relief. Applying the *Mobile-Sierra* doctrine to such contracts cannot be squared with the purpose for which that doctrine was originally developed, nor is it consistent with the FPA's mandate that contracts yield just and reasonable rates.

The *Mobile-Sierra* doctrine should not be applied to contracts consummated in markets like those in the western United States during 2000-2001. The preconditions for its application are not present. In severely dysfunctional markets like those at issue, FERC should address requests to reform contracts entered into at market-based rate by determining whether the rates in question were just and reasonable using the statutory standard as traditionally applied. Any other approach inevitably exposes wholesale power purchases (and

the end-users they serve) to the full impact of seller market power and manipulative conduct with no recourse. That outcome cannot be squared with the clear mandate of the Federal Power Act.

III. THE NINTH CIRCUIT'S DECISION TO REMAND THESE PROCEEDINGS DOES NOT THREATEN THE STABILITY OF ENERGY MARKETS, LONG-TERM CONTRACTS OR INFRASTRUCTURE DEVELOPMENT.

The effect of the decision below does not threaten the stability of energy markets or long-term contracts nor impair the development of needed infrastructure. Such allegations, advanced by Petitioners and their allies, are, at a minimum, significantly overstated. Any serious analysis of the Ninth Circuit's holdings in context strongly suggests the long-term impact will be limited. The unusual market conditions the Ninth Circuit relied upon to justify review of the subject contracts using the traditional "just and reasonable" standard, are unlikely to recur -- in part because of adjustments Congress and FERC have made to the agency's market oversight regime.[34] Indeed, even FERC

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[34] *Snohomish*, 471 F.3d 1053. According to FERC, the Ninth Circuit's finding that FERC lacked effective oversight during the Western energy crisis is primarily of historical interest because the oversight regime that exists today is very different. FERC Op. Br. at 14. FERC Merits Br. at 29-30. The current Chairman of the FERC contends FERC's present market-based rates program "bears little resemblance to the program the [Ninth Circuit] criticized." Statement of FERC Chairman, Joseph T. Kelliher, *available at* http://www.ferc.gov/news/statements-speeches/kelliher/20

acknowledges the contracts at issue were consummated in "the highly unusual context of the 2000-2001 western energy crisis – the worst electricity market crisis in US history" and that "no other case addressed facts even remotely similar to those at issue here . . . . [which] arose from an unprecedented confluence of [events]."[35]

Moreover, in its brief opposing certiorari, FERC also indicated that the Ninth Circuit's decision would have only limited impact, suggesting it merely stands for:

> the *narrow* proposition that, if there is a *credible claim* that *severe market dysfunction* has *affected* the *formation of a market-based contract*, the Commission must take that fact into account in determining whether the public-interest standard of *Mobile-Sierra* applies to its review of that contract.[36]

These and other FERC statements[37] have *already signaled* to wholesale electric markets,

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07/06-21-07-kelliher-E-1.pdf. Elsewhere, FERC explains that the *Snohomish* decision "addressed a unique set of facts and a market-based rate program that has undergone substantial improvements since 2001." *CAlifornians for Renewable Energy, Inc. v. California Public Utilities Commission ("CARE")*, 119 FERC ¶ 61,058 (2007) , para. 29.; FERC Op. Br. at 16.

35 *Id.* at 12, 22-23.

36 *Id.* at 12 (emphasis added).

37 *Id.* at 11, 24 (Citing Petitioners' assertions that the Ninth Circuit's decision places the *Mobile-Sierra* doctrine in

that, barring unusual market conditions and a clear breakdown of its current oversight regime, FERC is likely to continue to consider contract rates presumptively just and reasonable even if this Court upholds the basic thrust of the Ninth Circuit decision.[38]

The *Mobile-Sierra* doctrine has never been understood as a complete bar to FERC reformation of contracts.[39] FERC's statement, *supra*, suggests that the Ninth Circuit's decision merely adds one additional criteria -- severe (and, until 2000, unprecedented) market dysfunction -- to the review *mandated* by the Federal Power Act when that wholesale power rates are challenged as unjust and unreasonable. However, *even if the decision below does result in a significant increase in the level of scrutiny FERC applies to wholesale electric contracts*, history suggests that buyers and sellers (and markets) can efficiently accommodate such reviews.

For years, wholesale electric markets operated through tariffs and contracts subject to challenge and federal agency review. Many States

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"the historical dustbin" and claiming its "longstanding commitment to contract stability has not lessened in the wake of the decisions at issue here"). See *CARE*, 199 FERC ¶ 61,058 para. 40.

[38] See Snohomish January 7, 2008 Brief on the Merits at 58-59 ("Snohomish Merits Brief") noting "because the 2000-2001 crisis was so unusual, investors view the event as *sui generis*, and intervention by FERC will, therefore, create little, if any, regulatory risk."

[39] FERC Op. Br. at 23, noting that "[i]n two of the decisions on which petitioners rely, the courts of appeals actually affirmed Commission decisions to *reform* a contract under *Mobile-Sierra*."

also have the power to review contracts entered by jurisdictional utilities for reasonableness and prudence. Those States can limit or deny recovery of *certain* contract costs in rates when specific findings are made. This State-level review is well understood and readily accommodated by the capital markets and market participants.

Moreover, re-examination of the subject contracts in these circumstances can only make the markets operate more, not less, efficiently. Increased scrutiny of wholesale electric contracts entered during severely dysfunctional markets will only make clear what market participants should know already. If the United States, *for the second time in its history, experiences another episode of extreme market dysfunction*, sellers seeking either to manipulate the market or to take advantage of the successful manipulation of others to increase the prices to entities that serve end-user customers, should anticipate that such contracts may be the subject of FERC regulatory review and possible reformation. Put another way, the "certainty of contract" arguments advanced by Petitioners should have little application to contracts consummated during a period of extreme market dysfunction. This approach limits the impact of a dysfunctional market on end-user customers and provides an incentive for market participants to improve market function and stability rather than exploiting market defects.

One thing is already clear. If Petitioners and other market participants truly did not anticipate regulatory intervention in the market and the possibility of additional scrutiny and reformation of these contracts as a result of the conditions that

prevailed during the 2000-2001 crisis, they simply were not paying attention to events occurring in the surrounding environment. On November 1, 2000, *before the contracts that are at issue in this case were consummated*,[40] FERC, in decisions referenced in articles printed in the popular press,[41] concluded that the California market structure and rules were "seriously flawed," "provide[d] the opportunity for sellers to exercise

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[40] The Snohomish contract was executed on Jan. 26, 2001. The Southern Cal Water contract was signed on March 16, 2001 (Golden State Water January 7, 2008 Brief on the Merits at 13 ("Golden State Water Merits Brief"). The CDWR contracts were executed on dates ranging from February 6, 2001, through August 23, 2001. The first of the Nevada companies' contracts was entered into on November 10, 2000. The rest of the Nevada contracts were entered into after that date.

[41] See, e.g., Steve Puzzanghera, Jim & Johnson, *Regulators Pursue More Energy Refunds, Federal Agency Says Six Firms may Owe $55 Million*, San Jose Mercury News (March 17, 2001); Steve Johnson, *State Targets Power Suppliers for Refunds – Three Agencies are Trying to Determine whether wholesale electricity suppliers conspired to inflate prices. The goal is to obtain refunds for consumers*, San Jose Mercury News (January 7, 2001) ("U.S. Sen. Barbara Boxer....asked the U.S. Justice Department to join the investigations. An Official . . . said Friday that the request is under review . . . Some of those involved in the inquires voice confidence that at least a few of the firms ultimately will be compelled to pay refunds."); Michael L. Allan, *Commentary – When Power Price is High Enough, the Fish Become a Side Dish*, Los Angeles Times (December 15, 2000) ("The requested audit and a congressional inquiry should go forward."); Nancy Vogel, *Power Crisis Puts Spotlight on Middlemen – Deregulation: Federal officials seek to minimize the role of energy brokers*, Los Angeles Times (December 18, 2000); *FERC's California order leaves SoCal Ed 'on the brink of financial ruin'*, Inside FERC (December 25, 2000) at 5.

market power when supply is tight" and "can result in unjust and unreasonable rates."[42] It also suggested that these conditions could impact the forward contracts at issue in this appeal.[43] Approximately a month later, on December 15, 2000, FERC expressed concern that "unjust and unreasonable rates . . . could continue to be charged unless remedies are implemented,"[44] "strongly urge[d]" market participants to enter into long-term contracts like those at issue here,[45] and alerted market participants that it would "be vigilant in monitoring the possible exercise of market power" and that it would "monitor prices in those [long-term] markets" in order "[t]o address concerns about potentially unjust and unreasonable rates." [46]

Given FERC's public statements, it is difficult to understand how Petitioners could possibly have been surprised that contracts formed in and affected by this dysfunctional market would be the subject of both FERC review and possible reformation. At a minimum, they should have anticipated the filing of the FERC complaints that were the genesis of this appeal and the basis for the

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42 See *San Diego Gas & Elec. Co.*, 93 FERC ¶ 61,121, at 61,349-50 (2000).

43 *Id.* at 61,367. "These higher spot market prices in turn affect the prices in forward markets." See also *San Diego Gas & Elec. Co.*, 93 F.E.R.C. ¶ 61,294, ¶ 61,993 (2000) (FERC acknowledges that moving purchases rapidly into the long-term (forward) market might well create yet another "strong sellers' market). J.A. 521a-522a.

44 J.A. 535a-536a.

45 J.A. 519a.

46 J.A. 520a, 522a.

Ninth Circuit's decision. Despite FERC's statements, and the lengthy proceedings that have resulted in this appeal, market participants have continued to contract for wholesale power and develop necessary electric infrastructure. It does not appear that those FERC statements, or the subsequent uncertainty surrounding the FERC, Ninth Circuit, and Supreme Court reviews of these Section 206 complaint proceedings have had any deleterious impact on energy contracting, market stability, or infrastructure development.

Given the likely limited application of the Ninth Circuit's decision – distinguishable on its face from most future cases given the presence of an enhanced FERC market oversight regime and the absence of the most dysfunctional electricity market "in US history" – it is difficult to give credence to the contention that upholding the essential thrust of the Ninth Circuit's decision will have a significant impact on future long term contracts, market stability or infrastructure development. However, assuming *arguendo* that there is some incremental negative impact based on increased FERC scrutiny of contracts consummated in a severely dysfunctional markets, that fact should have little relevance to this Court's analysis here. Congress has mandated that all rates be just and reasonable and that FERC act to correct rates that are not consistent with this statutory test. The FPA contains no "contract-market-infrastructure development impact" exception to this mandate.

CONCLUSION

NARUC respectfully requests this Court affirm the Ninth Circuit's determination to remand these contracts for further consideration by FERC. The FERC incorrectly applied the *Mobile-Sierra* doctrine to effectively insulate the challenged contracts from FPA mandated review.

Reexamination of these contracts is unlikely to have a significant impact on the stability of contracts or infrastructure development. However, even if it does, Congress made no exception to its mandates both that contract rates be just and reasonable, and FERC correct those that are not. And, it simply is not reasonable to presume that contract rates are *when all available record evidence supports the opposite conclusion.* On remand, FERC should be required to reexamine the evidence of the soundness of the forward energy markets during the Western energy crisis. If the agency concludes those markets were not effectively competitive and/or that the market was severely dysfunctional, it should determine whether the rates set out in the challenged contracts were just and reasonable using traditional standards and order any necessary contract reformation to ensure compliance with the FPA's mandate.

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